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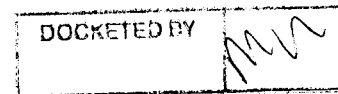
May 20, 2010

Commissioner Sandra D. Kennedy
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED

MAY 20 2010

Re: Docket No. E-01345A-08-0172



Dear Commissioner Kennedy:

Arizona Public Service Company ("APS" or "Company") would like to respond to your letter dated April 27, 2010 concerning the over-collection of the APS Power Supply Adjustor ("PSA"). In doing so, the Company will address your specific questions posed by the letter.

- Question No. 1:** In general, what is APS's hedging policy/practice for securing fuel? In particular -
- a. What percentage of APS' fuel is hedged?
 - b. How far in advance does APS hedge?

Answer No. 1: The APS hedge plan is a three year plan with varying hedge amounts for each year. For example, natural gas and purchased power is hedged approximately 85% for the current year, and about 50 % for the three year plan. Coal and nuclear fuels are not hedged, per se, but are under contracts that provide APS and its customers protection against short-term market volatility. Renewable generation is likewise not subject to market volatility.

- Question No. 2:** What is the interest rate that APS is earning on the over-collected PSA balance?

APS • APS Energy Services • SunCor • El Dorado

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Answer No. 2: The PSA balance does not represent a discreet source of money that APS can invest, but rather it is simply an accounting entry. If the PSA balance did reflect surplus cash to the Company, any earnings would be minimal (ranging from .03% to .4%) and as noted below, would be more than offset by the interest paid customers on such balance.

Question No. 3: **What is the interest rate that APS is paying to its rate payers on the over-collected PSA balance?**

Answer No. 3: Per the PSA Plan of Administration approved by the Commission, PSA balances (plus or minus) currently earn interest at the rate of .45%.

Question No. 4: **What is the maximum over-collection PSA balance that APS expects to reach during calendar year 2010? When does APS expect to reach this maximum?**

Answer No. 4: The maximum "over-collection" has likely already occurred (end of April). Although final results are not in, the expected balance at April 30 was approximately \$110 million for the combination of the forward and historical components of the PSA. Thereafter, it is expected that the PSA balance will decline dramatically until the end of the summer season.

Question No. 5: **What is the minimum over-collection PSA balance that APS expects to reach during calendar year 2010? When does APS expect to reach this minimum?**

Answer No.5 The low point for the historical component of the PSA balance will come at the end of the year, as is intended by the PSA Plan of Administration approved by the Commission. That low point will be an estimated \$10 million, and it will be less than \$5 million at the end of January 2011 (the end of the "PSA Year"). The low balance for the forward component of the PSA generally occurs at the end of the summer season, and this year is expected to be no different. Again, that low point is forecast to be approximately \$6 million as of the end of September. The minimum combined balance is forecast to occur in October. That forecast balance will be approximately \$31 million consisting of \$10 million in the Forward Component Balancing Account and \$21 million in the Historical Component Balancing Account. Again, the historical component balance is in the process of being returned to customers as a result of the Company's last rate order in December of 2009.

Question No. 6: **Does APS have any plans to refund some portion of the over-collected PSA balance prior to the annual true-up date of February 2011? If not, why not?**

Answer No. 6: APS has no such plans at present. The PSA Plan of Administration provides a mechanism for refunding any over-collected balances to customers, and it is the Company's intent to let the mechanism work as approved by the Commission in previous APS rate cases. There are several reasons why this is appropriate, both as a general proposition and in this specific case:

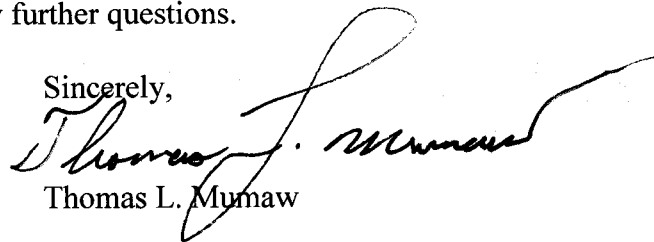
- \$73 million of the \$102 million PSA credit balance is already being refunded to customers through January 2011 through the historical component of the PSA.
- As to the portion of the credit balance that is not currently being refunded, current forecasts show that APS will have an over-collection of approximately \$6 million at the end of the summer - a number that can easily fall and become negative if the summer is hotter or the hurricane season is worse than anticipated.
- When the refund now being paid back to customers (with interest) ends in 2011, customer bills are likely to increase absent a positive balance in the PSA. In any event, the February 2011 PSA will be higher if any potential positive balance is totally refunded this year. This PSA increase, as well as potential future increases in other adjustor surcharges, will be moderated if the PSA is permitted to work as designed and the refund of any new credit balance is synchronized with the expiration of last year's refund.
- The present PSA is viewed positively by the financial and investment community, and it is a significant factor in the "stable" characterization of the Company's current investment ratings. Attempts to modify its operation may be viewed negatively in light of the uncertainty that always surrounds fuel and purchased power prices.

For the foregoing reasons, APS believes that the PSA should operate according to its Commission-approved Plan of Administration, initiating a refund with interest of any credit owed beginning in February 2011. Alternatively, the issue of whether any credit balance remaining at the end of the summer should be refunded to customers in 2010 is one that should be reviewed at that time, when there is greater certainty.

Commissioner Sandra D. Kennedy
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Please do not hesitate to contact me should you have any further questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Thomas L. Mumaw", with a long, sweeping horizontal line extending to the right.

Thomas L. Mumaw

TLM/na

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